DOCUMENT RESUME

ED 195 024 EA 013 117

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TITLE The Uncertain Economic Outlook: The Schools' High Stakes in It.
INSTITUTION National Education Association, Washington, D.C.
PUB DATE Apr 80
NOTE 12p.: For a related document, see EA 013 118.

EDRS PRICE MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS Credit (Finance): *Economic Climate: *Economics: Elementary Secondary Education: Employment Patterns: Federal Legislation: *Financial Problems: Housing Industry: *Inflation (Economics): Interest: *Prediction: Retrenchment: Social Influences: Taxes

ABSTRACT

Written in the first quarter of 1980, this paper describes economic conditions at that time and makes projections concerning the future. The paper attempts to present a brief look at the same issues surveyed in the longer report EA 013 118. After warning that economic conditions are hard to assess and still harder to predict, the author asserts that most forecasters agree on one issue: the inevitability of a serious and year-long recession. He cites as evidence President Carter's attempt at austerity measures summed up by the proposal to chop $13 billion from the federal budget and efforts by the Federal Reserve Board to cut inflation by raising interest rates on borrowing. He notes that the housing market, a good predictor of the health of the overall economy, is already in a depressed state. The author adds that nowhere does the potential for lasting damage from inflation manifest itself more vividly than in the country's classrooms. (Author/JM)

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EA 013 117

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THE UNCERTAIN ECONOMIC OUTLOOK: THE SCHOOLS' HIGH STAKES IN IT

John Gerrity

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PREFACE

The public school establishment has a multifold interest in and concern with the condition of the nation's economy and its prospects for the 1980's. As citizens, voters, taxpayers, and homemakers, public school personnel share the concern of all Americans in their own and their families' and neighbors' economic well-being. But economic conditions affect teachers in more direct ways, as well. By their impact on governments' revenue resources, economic conditions influence the quality of work teachers are able to do in their classrooms, in the environment in which they have to function.

Continued inflation (and the fiscal stringency that accompanies it) is debilitating public school institutions. It is resulting in deferred maintenance of school plants, facilities and equipment; in depleted inventories of school supplies and teaching materials; in payscales lagging behind cost-of-living increases; and in erosion of fringe benefits and underfunding of retirement systems. Overcrowded classrooms presided over by discouraged and disenchanted teachers take their toll.

Teachers, administrators, and parents are witnessing at firsthand the effects of these troubled economic times on the 40-plus million students in the public schools. Most, however, are preoccupied with their own jobs, unable to keep abreast of the ups and downs of the nation's economy. To help fill this void, NEA Research commissioned Richard E. Slitor, a private economic consultant with excellent professional credentials, to review and analyze the economic outlook at the start of the 1980's. Further, mindful of those who lack the time to study Dr. Slitor's full report—which is available on request from NEA Research—we have arranged with John Gerrity, a free-lance writer of national repute, to prepare this brief account of our limping economy and what is being done about it.

April 1980

Frank W. Kovacs
Director of Research

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THE UNCERTAIN ECONOMIC OUTLOOK: THE SCHOOLS' HIGH STAKES IN IT

If crafted by a cynic, a composite profile today of the nation's fraternity of economic forecasters might very well resemble Janus, the mythological Roman god who was able to look in two directions at once.

In this imaginary profile, one set of eyes appears to be glued on a vast mass of the unknown. The other seems to be transfixed by a bewildering admixture of cross purposes, contradictory signals, imponderables of all sorts, and downright confusion.

In either or both instances, vision is sadly impaired. The portents for improvement are feeble. This is the conclusion that emerges from a detailed, analytical summary of the nation's economic outlook for the early 1980's—as seen by some of the more notable professionals—prepared for the National Education Association by Dr. Richard E. Slitor, a private economic consultant.

Aches and pains of all kinds

While economic uncertainty and inflation imperil every entity in the nation, they strike uniquely at the jugular of the public school system. There is scarcely an area of the educational system that escapes injury in an environment of economic uncertainty bordering on fear, accompanied by skyrocketing costs.

Physical facilities of all kinds; school populations; virtually every extracurricular activity; teachers' salaries; retirement systems; continuing education programs; teaching aids of all sorts; specialized types of instruction for the handicapped, the disadvantaged, and the exceptional child; and the morale of students, teachers, and parents—all suffer.

It would be difficult to pinpoint an area of domestic activity more sensitive to the inroads of a faltering economy and inflation than public education. In brief, it may safely be said that the degree of adversity they bring to the public school system, they also bring to the country as a whole.

Economic Forecasting

Cloudy crystal ball

Economists, as practitioners of an arcane trade, have never had a very easy time of it. This is so whether they have been engaged in predicting the shape of the future events or in managing an economy that they have helped to fashion. Indeed, circulating almost constantly in business and financial quarters is a virile suspicion that in the latter function—management—economists all too frequently guide or push or otherwise maneuver circumstances in an attempt to bring about the fulfillment of their own forecasts.

John Gerrity is a free-lance writer and former Washington bureau chief of *The Bond Buyer.*

This allegation, of course, is grossly unfair. . .especially at this particular time. It is always difficult—even with the benefit of highly sophisticated gadgetry, such as computers and the like—for any mortal to predict how others will or will not behave, economically speaking, weeks or months or even years ahead in an extraordinarily complicated society. Today, the fine art of forecasting has moved from difficult to hazardous. And the why of this can be readily defined.

Given the complexities of what most have proclaimed the most advanced nation in the history of the world, consider the nerve-janglings that must result when extraneous and uncontrollable—yet influential in a near-hypnotic way—events and developments are sluiced into the forecasting formula. Here, for example, are a few that are pertinent now:

A troubled world

- A worldwide energy crisis that can be worsened or bettered any hour of any day by the whims of probably the most effective pricing cartel of modern times, the Organization of Petroleum Exporting Countries, the perpetrators of a hitherto-unheard-of brand of oil price gouging.
- The near collapse of more than a decade of a reasonably tenable detente between the United States and Soviet Russia, a deterioration in relations symbolized by a U.S.-sponsored, multination boycott of the Moscow Olympic games and by the U.S. embargo on the sale of grains and the export of high technology tools, machinery, equipment, and replacement parts to Russia, with the threat of still more of the same to follow.
- The invasion of Afghanistan by the Soviets and the spectre of their political domination of a huge chunk of the world, stretching from the Mediterranean to the western borders of India.
- A state of hostility between the United States and Iran entailing U.S. citizens held as hostages by terrorists and international brigands, who are unstayed in their madness by the distinct possibility that blatant lawlessness could easily envelop the entire Middle East and ignite even greater calamities.
- The uneasy economic and political alliance among the U.S. and Western European countries, Canada, and Japan—whose cosmetic harmony is undermined by selfish and self-serving national interests.
- A virulent, worldwide inflation contaminating to some extent every industrialized country in the world, spilling over into scores of underdeveloped countries in a manner that has so far defied abatement or even clear definition. Domestically, this self-same inflation has moved dangerously near to paralyzing critical segments of the economy.

If these so-called "external" forces and others not listed here aren't sufficient in themselves to make silly putty out of the props on which any sound economic forecasting must depend, there's one more that ought to be added to the awful mix. Like the others, this, too, is beyond any economist's ability to influence or, for that matter, to assess accurately.

A Presidential Election Year

How, it must be asked, can economists worthy of their calculators be expected to produce a reliable prediction during that quadrennial national hysteria euphemistically dubbed "a presidential election year."

Besides choosing a President this year, the voters will also elect the full membership of the House of Representatives, one third of the Senate, and at least one house of 44 state legislatures–an exercise of exceptional interest in 1980, since it will be the job of the state legislatures to redistrict the nation following the decennial census to be completed this summer. This head count will control among other things congressional representation and state entitlements to sundry federal grants.

The impacts of national elections

This political phenomenon at all levels of government has generated a spate of uncertainties that is at least staggering. Congress has adopted and shifted its positions on such key issues as energy, budget making, taxation, foreign trade, national defense, aid to cities and states, jobs, and the environment numerous times over an 18-month period. That more policy shifts are likely in the near future is not an extravagant guess.

President Carter, anything but an impulsive man, has been almost as nimble. In the short span of less than a half a year, the President has developed and proposed several different programs to deal with the problems of inflation. Twice in less than six weeks he has submitted two budgets for the fiscal year that starts next October 1, each calling for the spending of nearly two-thirds of a trillion dollars.

This seeming propensity for sudden and frequent policy changes by both the national legislature and the executive is not always necessarily sparked by some latent ambivalence or deep-rooted indecisiveness. To assert that the President or Congress vacillates on critical national issues merely to keep their respective political images bright and glossy is probably misleading and untrue.

A Recession Is Virtually Inevitable

The game of catch-up

World affairs today move at a bewildering pace. More often than not, a shift by the makers of national economic policy is dictated by events in other countries over which the U.S. can exert no control and precious little influence.

Small wonder, therefore, that the nation's foremost economic forecasters–and the list includes such household names as Data Resources, Inc., headed by former presidential adviser Otto Eckstein; the Heller-Perry economic outlook letter, sponsored by the National City Bank of Minneapolis; the economic arms of such institutions as First National City Bank and Chase Manhattan, of New York, and the Wharton Business School, of the University of Pennsylvania; the President's own Council of Economic Advisers; the Congressional Budget Office; the Brookings Institution; the American Enterprise Institute; and the Office of Management and Budget, plus leaders of the financial press, including the *Wall Street Journal, Business Week, Fortune, Dun's Review, American Banking,* and the *Journal of Commerce*–have found it so difficult to reach common ground in assessing key economic factors or trends, or to achieve a consensus on the more important issues, save one:

- That a recession is now virtually inevitable; and when it comes, it will be broadly based and likely to be durable enough to survive for a full year.

The elusive agreement

Yet even this single point of agreement was not always thus. Early in 1979, most forecasters were predicting an economic downturn of some real significance. But there was little agreement on when the recession would strike, how long it would last, and how intense it might be. But nearly all of these differences have now vanished, all but erased by an astonishing turn of economic events during the first three months of the year.

If by some unhappy accident, the 1980's should follow the patterns set at the outset of the year, this may come to be known as "the decade it would be best to forget."

On almost every front and from nearly all sectors the news was bad, leaning toward dismal. How bad and how dismal was clearly demonstrated toward the end of the first quarter when the President, his senior advisers, and the leaders of the Democratic and Republican contingents in Congress acknowledged they had no alternative but to place the country on a course to genuine austerity.

Cutting the Federal Budget

For a man not given to elaborate stage-setting, Mr. Carter's decisions to revamp and balance the federal budget for fiscal 1981, to intensify efforts to conserve energy by imposing a 10-cent levy on every gallon of gasoline, and to invoke the most severe monetary and credit restraints since the end of World War II was the stuff of high drama.

Fiscal maneuvering

Inflation, approaching a 20-percent annual rate, was clearly the villain in the piece. The President signified this when he deliberately put great emphasis on his desire to chop some $13 billion from the $616-billion spending budget he had sent to Congress on January 28 and to wash out the remainder of his earlier $16-billion deficit by raising an additional $3 billion in revenues through tax withholding on interest and dividends paid to individuals.

The single biggest budget cut under consideration is a $1.7-billion reduction in general revenue sharing for the states, an action that ultimately will affect cities and counties more than the states themselves after the full impact of the revised pass-through of funds has been calculated. This cut will come on top of another proposal to eliminate about $1 billion that now goes to the cities under the so-called countercyclical revenue sharing. Still another estimated $1.2 billion would be saved by determining cost-of-living increases in federal civilian and military pensions once a year, instead of twice a year as is now the case.

Although the White House decided to postpone the disclosure of the details of budget cuts, aides revealed the most likely targets for federal saving. Some $850 million can be trimmed by foregoing planned additions to the country's emergency oil inventories; another $800 million of spending can be saved by postponing reforms in the national welfare system. A like sum can be realized by lopping about 20,000 jobs from the federal government's payroll.

Still another $800 million or slightly more can be saved by dropping Saturday delivery of the mails; $500 million will be recaptured by paring the CETA job-training program; $400 million can be lopped from health assistance; and an additional $300 million can be saved by tightening the current food-stamp program. Other cuts will be made throughout the entire government apparatus, notably in such departments as Education and Health and Human Resources, whose budgets may be trimmed by as much as $1 billion, some of it in scattered federal-aid-to-education programs.

Congress, pushing ahead with its own plans for budget trimming had produced an even more ambitious list of cuts totaling $16.4 billion, topping President Carter by $2.4 billion. Whether the President will accept Congress' sterner recommendations, should they materialize, is problematical. It's most unlikely that he would veto a bill calling for sharper spending reductions than he had proposed. But he can, if he chooses, simply ignore those congressional proposals he considers too harsh or politically risky.

Belt-tightening

The Federal Reserve Board

For the past year or so, the central bank has sought to have the marketplace determine who should get credit simply by letting interest rates rise as high and as rapidly as money demands dictated. This strategy was based on two assumptions: That the money supply in all forms would remain relatively constant and that at some lofty point the price of money (interest) would choke off most borrowers, just as other commodities and services can be—and have been—"priced out" of the market.

Both assumptions proved faulty. The Federal Reserve soon discovered that because of continuing high inflation, too many borrowers were willing to pay almost any price for money and that high rates were an ineffective deterrent. Long aware that its power to control the total volume of money was largely a fiction, the Fed learned to its sorrow that businesses and consumers were uncovering gaps and holes in its monetary defense, many of which were heretofore unsuspected and hence unused.

A year-long recession?

By invoking the broad powers of the Credit Control Act of 1969, the central bank can now make it far more costly for lenders to increase their consumers' borrowings. At the same time, it can reduce the quantity and amounts of business loans merely by imposing stiffer reserve requirements on virtually all kinds of loans, excepting only mortgages, which had become prohibitively exorbitant even before the new credit restraints had been slapped on.

Further, the Fed's power to limit the growth in money supply has been strengthened by the new measures to the extent that nonmember commercial banks will now be subjected to many of the same restraints as apply to the Federal Reserve's member banks. In an inflationary climate, as prices rise, more and more money is needed to finance the same level of economic activity. If the lid can be kept on the total supply of money and if the new clamps on the use of credit are not eased, sooner or later the demand for goods and services is bound to shrink. In short, assuming the central bank does not abandon its new posture of toughness, the diminishing demand and declining economic activity will be translated into a recession, one that will persist until restraining policies are reversed.

Problems in the Housing Industry

Indeed, some sectors of the economy, notably the housing industry, are already in a depressed condition or on the verge of entering a very real recession.

The collapse of housing

The latest housing statistics developed by Michael Sumichrast, chief economist for the National Association of Home Builders, and adopted by the U.S. Commerce Department now suggest that new housing starts in 1980 will total about 1.1 million, some 900,000 fewer than the 2 million-plus in the peak year, 1978.

"At current mortgage rates of 15 to 17 percent, there is no way the housing industry can start the number of single-family units or multifamily projects predicted only a few months ago," Mr. Sumichrast asserts.

It has often been said that housing—like the auto industry with its volatile output of cars or the nation's education system with its sensitivity to economic expansions and contractions—reflects most accurately the health or lack of health in the overall economy. It has become almost an article of faith that recessions arrive on the back of a declining housing industry and depart when housing starts to revive. If this article of faith is sustainable, and if the drop now being forecast is realized, there will be:

Irretrievable losses

- A direct monetary loss to the overall economy of $111.8 billion.
- A loss of about 1.5 million years of employment, equated in terms of individuals, in building and allied industries (not including appliances or furniture) with a concurrent loss of about $25 billion in wages.
- A drop of about $6.8 billion in tax revenues to the federal government.
- A decline of about $420 million in personal income tax revenues to the states.
- A loss of about $1.2 billion in local real estate taxes.

And these are direct impact figures, Mr. Sumichrast notes. They do not reflect indirect effects in other industries. And they are, he emphasizes, the "definitive substance of what makes a recession."

A Detailed Analytical Summary

The National Education Association recently published Dr. Richard Slitor's impressive and highly detailed analytical summary of the individual economic surveys made by some of the more notable professionals in the field. This summary of the views of the nation's leading economists, written shortly before the President and Congress started to apply the fiscal screws to the economy and before the Federal Reserve had lumbered its big credit-restraining guns into place, does not suffer noticeably from any lack of prescience.

Among other things, the synthesis of the weightier economic forecasts, as presented by Dr. Slitor, suggests that—

- The nation's jobless rate, now hovering in the 6-percent range, will rise gradually during the balance of 1980, reaching a high point of about 8 percent during the last quarter. How long it will remain at that level depends almost entirely on the life of the anticipated recession.

Mixed indicators

- Inflation is expected to continue at a rate of about 1.5 percent a month or 18 to 20 percent in annual terms. The inflation rate during the summer months may even exceed this level, pushed upward by the new 10-cent levy on gasoline. The fact that expected fiscal restraints will not take effect until the start of the final quarter of the calendar year serves mainly to emphasize the increasing burden the Federal Reserve must shoulder, if cooling off the economy is to remain the political order of affairs.

- Corporate profits are expected to continue to increase during the year, but probably by no more than 10 or 12 percent. Oil companies and other energy producers, together with defense industries, are expected to be the big gainers.

- Retail sales are expected to remain relatively stagnant, neither declining nor increasing by any significant percentage. To the extent that retail sales are influenced by the curtailment in the use of bank credit cards and other forms of "plastic currency," sales will probably decline. Gasoline prices are expected to rise to $1.50 a gallon at the pump and remain there for the balance of the year, barring another big hike in wholesale prices by OPEC suppliers.

- Auto sales, down by about 20 percent from 1978 levels, are expected to total about 9.1 million units, a drop of over 13 percent from 10.5 million units last year. Because auto sales were specifically exempted from the Fed's new credit restraints, total sales may improve over the present forecasts, especially if some of the money that otherwise might have gone into new housing shifts to the auto market.

- And, finally, the gross national product is expected to total $2559 billion in current dollars for 1980 as a whole. This total in output is adjusted downward by 9.5 percent to reflect a full-year rate of inflation.

More credit restraints to come

- Obviously, these forecasts and others are now highly vulnerable and will remain so until final fiscal and monetary policies for 1980 and for several months thereafter have jelled. It is also obvious that the host of uncertainties that detracted from the accuracy of predictions made late in 1979 or at the start of this year will not be appreciably diminished.

No one really knows how deep the Federal Reserve's credit bite will be. Nor does anyone know today whether the central bank will impose still more restraints, as it can if the ones adopted in mid-March prove insufficient to do all that's expected of them.

Possible Tax Cuts

Neither does anyone have any firm notion when and at what level fiscal activities will be cut back. On the day President Carter unveiled his anti-inflation plan, he vowed there would be no tax cuts until a balanced budget was an established fact of fiscal life. That is to say, that no tax reductions would be considered by the Carter Administration until next November or December at the earliest, at a time probably too near to adjournment to permit any congressional action this year.

Which way, taxes?

However, in an address before the National League of Cities, Mr. Carter opened the door to future tax cuts if they were directed predominantly toward encouraging saving and new capital investment.

Similarly, substantial uncertainties surround the ultimate disposal of the yield expected from the new 10-cent levy on every gallon of gasoline sold at retail. The President prefers to apply the anticipated total of $11 to $12 billion to a reduction in the national debt. Failing that, Mr. Carter said, the tax yield

should be held as a sort of cash reserve, to be used only if some unexpected new budget crisis should develop.

Yet, even as Mr. Carter was voicing his views, many members of Congress were contemplating ways to use the money for future tax cuts. Some went so far as to suggest that the special gas tax could provide the base for a $15-billion tax cut, $5 billion to go to corporations and $10 billion to individuals.

A High Price To Pay

So long as the doctrine of separation of powers prevails in the national government, uncertainties of the sort surrounding the new gasoline tax, as well as most other programs and policies, will persist. And so long as uncertainties cast a shadow over the course and outcome of national economic policies, any credible prediction on the life of inflation, the nature and extent of any possible recession, and the overall outlook for the nation's economy will remain elusive.

A cruel price

Nowhere in the broad spectrum of national affairs does the potential for lasting damage from inflation manifest itself more vividly than in the country's classrooms. In simplest terms, it ought to be remembered that the loss our youth suffers as a result of inadequate instruction for a year can never be fully recouped.

It is in this context that the awful cost of inflation rips at the real fabric of national well-being. This, indeed, is an unacceptably high price to pay.